CHAPTER IV. FINANCING THE FAA PLAN

Like other federally funded aviation projects, the National Airspace System Plan would be financed with aviation taxes paid into the Airport and Airway Trust Fund. Financing the plan is subject to some of the same uncertainties that influence its potential cost-effectiveness. In particular, if FAA's projection of growth in air traffic or airline fares proves too high, or if its estimates of capital costs proves too low, revenues could fall short of the required level of authorizations. The present financial condition of the trust fund does not support such apprehension. The fund is projected to end 1983 with a cash balance of $4.6 billion, of which $2.2 billion would remain uncommitted. On the other hand, the present price wars among commercial airlines and excess numbers of seats suggest a less sanguine outlook.

The first two sections of this chapter assess the trust fund's financial status and analyze key aspects of the risk of trust fund receipts' being inadequate to finance the FAA plan. The third section evaluates the possible implications of recent appropriation legislation that limits radically the Federal Aviation Administration's claim to trust fund revenues in 1984. The projection period of this analysis stops at 1987--far short of the projection period examined elsewhere in this study--because the trust fund is currently authorized only through 1987.

THE AIRPORT AND AIRWAY TRUST FUND

In 1970, the Congress created the Airport and Airway Trust Fund as a repository for the tax monies paid by aviation users for federal aviation programs. By holding aviation revenues separate from other federal income, the trust fund has accomplished three purposes. It has assigned the capital costs of airports and traffic control specifically to users of aviation services and prevented those costs from burdening taxpayers in general. It has ensured that the taxes paid by aviation users be used for aviation purposes. And it has provided an assured mechanism for financing long-term capital aviation projects. The trust fund finances all federal spending on airport capital projects, including the air traffic control system. 1/ Only about

1. Exceptions are Washington, D. C.'s National and Dulles Airports, which, though owned and operated by the federal government, are financed largely outside the trust fund.

three-quarters of the operating and maintenance costs of the air traffic control system are financed in this way, however, with the balance being drawn from general federal revenues. 2/

The trust fund is simple in concept: aviation users pay into the fund, and expenditures to support federal aviation programs are drawn from the fund. 3/ As shown in the table below, users pay through separate taxes in five categories:

Items Taxed	Current Tax Rate a/	Percent of Total Trust Fund Receipts in 1982
Commercial Airline Tickets	8 percent of ticket price	87.0
International Departures	$3.00 per passenger	3.3
Freight Waybills	5 percent of waybill	4.4
General Aviation Fuel		
Gasoline	12 cents per gallon	2.1
Jet fuel	14 cents per gallon	3.2

a. Unless renewed, these rates will drop to permanent levels in 1987.

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2. The limited use of trust funds for operating costs is attributable in large part to disagreement between the Congress and the Administration over the use of the fund when it was first set up in the early 1970s. In general, restrictions on the purposes for which user fees can be spent stem from the view that general taxpayers benefit from the military and other "public goods" applications of the airway system, making it fair for general taxpayers to cover at least part of the system's costs. This argument is inconsistent with the operation of certain other federal trust funds, however. The Highway Trust Fund, for example, is financed fully by highway users, despite any indirect defense or other benefits that nondirect beneficiaries might receive.

3. As stated in Chapter III, separate classes of users do not pay into the fund in proportion with their particular use; general aviation pays proportionately less while commercial aviation overpays. See also Congressional Budget Office, Public Works Infrastructure, Chapters VI and VII.

Receipts from these taxes--estimated to total $2.7 billion in 1983 and rise to $4 billion by 1987--go into the trust fund as they are collected, and subsequently they are withdrawn to pay for qualifying airport and air traffic control projects and for operation of the air traffic control system.

Projected Trust Fund Outlays

On the basis of authorizations in the Airport and Airway Development Act of 1982 (which includes authorizations for the FAA plan), outlays from the trust fund are expected to increase from about $2.0 billion in 1983 to $3.9 billion by 1987 (see Table 10). In 1983, almost 60 percent of this spending would go for air traffic controllers' salaries, equipment repairs, and other costs to operate and maintain the air traffic control system. In 1983, the federal share of airport development projects would use 22 percent of spending, while 15 percent would pay for initial procurements under the FAA plan. The remaining 7 percent would pay for research and development.

Over the period 1983 to 1987, total trust fund outlays are projected to nearly double; in addition, the mix of investments would change quite substantially. By 1987, trust fund outlays would total $3.9 billion, as against $2.0 billion in 1983, and capital spending for air traffic control is planned almost to triple its share of total trust fund spending, from 15 percent in 1983, to 35 percent in 1987.

STATUS OF THE TRUST FUND AND MAJOR FINANCIAL RISKS

Though income from the 8 percent tax on passenger tickets is the trust fund's chief source of financing, it is also the most difficult revenue source to forecast. Ticket tax revenues can vary according to two factors: numbers of passenger miles flown, and revenue produced by each passenger mile (called the "passenger yield"). Together, these two factors determine the revenue base for ticket tax collections and thus for trust fund revenues. Uncertainties underlying future trends in passenger miles are considered in Chapters II and III. This section evaluates trends in passenger yields and the associated financial risks for the National Airspace System Plan.

Trends in Passenger Yield

Passenger yield has been declining steadily since August 1981. Between September 1981 and March 1983, the average revenue per passenger mile for the previous 12 months fell by 14 percent, from 13.6 cents to

TABLE 10. BREAKDOWN OF PROJECTED AIRPORT AND AIRWAY TRUST FUND OUTLAYS, 1983-1987 (In billions of dollars)

Fiscal Year	Air Traffic Control: Capital Investments	Air Traffic Control: Operations and Maintenance	Airport Grants	Research, Engineering and Development	Total
1983 a/	0.31	1.17	0.44	0.11	2.03
1984 b/	0.56	1.24	0.80	0.22	2.83
1985 b/	0.91	1.26	0.95	0.26	3.38
1986 b/	1.24	1.30	1.00	0.24	3.78
1987 b/	1.35	1.36	1.04	0.20	3.95

SOURCE: Congressional Budget Office, projected from authorizations in the Airport and Airway Development Act of 1982.

NOTE: Details may not add to totals because of rounding.

a. Includes only appropriation action taken to date.

b. Assumes full appropriation of amounts authorized under the Airport and Airway Improvement Act of 1982 and the Surface Transportation Assistance Act of 1982. The impact of much lower appropriations under the Department of Transportation and Related Agencies Appropriations Act of 1984 is analyzed later in this chapter.

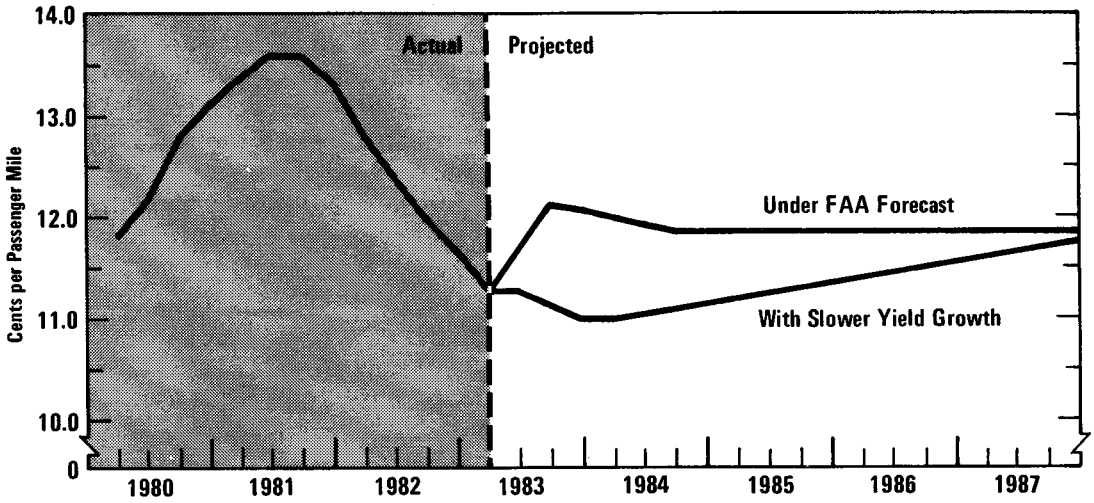
11.7 cents (in 1982 dollars--see Figure 5). For many carriers, this declining yield has imposed a heavy financial toll. Last year, the 12 largest domestic carriers lost a total amount exceeding $730 million. 4/

4. Some of this loss can be ascribed to the now-bankrupt Braniff Airlines. The 11 largest domestic airlines are American, Continental, Delta, Eastern, Northwest, Pan American, Republic, Trans World, United, USAir, and Western.

Figure 5.

Actual and Projected Revenue Yield to Commercial Airlines Per Passenger Mile, 1980-1987[a]

(Twelve-month moving average, in June 1982 dollars)



SOURCE: Congressional Budget Office from Civil Aeronautics Board and Federal Aviation Administration data.

[a] Excludes passengers on international flights.

The decline in yield, a result of heavy fare cutting, has two major causes:

- Airline deregulation, which permitted competition among airlines for both prices and routes; and
- Economic recession, which, by causing an oversupply of airline seats, encouraged price wars.

Airline Deregulation. The Airline Deregulation Act of 1978 progressively released U. S. airlines from virtually all constraints on access to air routes and on pricing. Predictably, competitive forces came into play as airlines expanded into markets that had previously been the exclusive

territories of other carriers. In many cases, airlines used reduced fares to attract passengers from competitors and to encourage new travelers. By October 1982, 80 percent of all domestic fares were discounted by an average of 53 percent from the full fare (and some by more than 70 percent). The result was greatly diluted passenger yield.

Fare wars have also resulted in part from new entrants into the airline industry since deregulation. Offering "no-frills" service--often with less costly aircraft (for example, previously owned planes requiring less debt service per seat) and with nonunion labor--these carriers could offer fares as much as 70 percent below earlier rates. Moreover, because of their lower cost structure, many such carriers appear able to make money despite lower fares. People Express, for example, turned an operating profit of $10.6 million in 1982, while Eastern Airlines lost $14.2 million.

Economic Recession. In addition to competitive forces, economic recession further depressed airline fares. Between 1979 and 1982, the number of airline passengers increased by only 1 percent, while the seating capacity of the aircraft fleet grew by 13 percent; many new aircraft had been ordered in the mid-1970s, when passenger demand was growing at a rate of 7.7 percent a year. As a measure of the problem, fully 10 percent of the world's 6,000 commercial jets were up for sale last year. Thus, by adding seats to a stagnant market, the airlines needed to sell tickets at a cut price determined not by the need for profit but by the market.

The outlook for passenger yields--critical to airline and trust fund revenues--in the years ahead is subject to various factors, some related to the economy as a whole and others affected by the behavior of the airline industry. Economic recovery could bring a resurgence of demand, diminishing surplus capacity and permitting price increases. Retreat from recovery, however, might again depress demand for air travel, thus leading to another period of overcapacity and, in turn, to renewed price wars. Independent of these factors, the airline industry itself might put a stop to this downward spiral, adopting a course of self-discipline to stop price wars; this would make possible some increases in fares but with possibly adverse effects on demand. Higher fares, of course, could invite more low-cost carriers to enter the market.

The FAA's Forecast and Major Assumptions. Before October 1978, while airline fares and routes were still tightly regulated, the FAA's record in forecasting passenger yield was quite good. Since then, however, most forecasters have underestimated the extent of price cutting.

The FAA is now projecting a sharp decline in price cutting this year and a return to the mid-1982 real dollar yield of 12.1 cents per passenger

mile by September (see Figure 5). To achieve this, average ticket prices must increase by about 10 percent between March and September 1983. The forecast is predicated on an optimistic view of the economy and a corresponding surge in air traffic.

On the basis of these assumptions, federal aviation user taxes would generate about $2.3 billion in 1983, with nearly 90 percent coming from taxes on commercial airline tickets (see Table 11). In addition, the substantial cash balance in the trust fund will earn about $500 million in interest, bringing total receipts to around $2.8 billion.

Over the period 1983 to 1987, the FAA forecasts that annual trust fund receipts (not including interest on the cash balance) will grow by about 12 percent a year, increasing from $2.3 billion in 1983 to $3.7 billion in 1987. Revenues from the most important revenue source--ticket taxes--will grow by 13 percent a year, producing collections of some $3.3 billion in 1987.

Given these revenue forecasts and the outlay projections presented earlier, the trust fund would continue in sound financial condition, being fully capable of funding all authorized aviation programs with receipts exceeding outlays in each year through 1987 (see Table 12). At the start of 1983, the trust fund had a cash balance of $3.9 billion. Part of this sum is needed to pay commitments that have already been made, but because of normal delays between authorization and completion of construction, it has not yet been spent. These unpaid authorizations are projected to total $1.7 billion, leaving $2.2 billion as uncommitted surplus. In large part because of the higher authorizations required by the FAA plan, the uncommited surplus in the trust fund would be drawn down from $2.2 billion to about $900 million by the start of 1987. (There is no compelling financial reason for maintaining such a surplus, and indeed, the existence of uncommited user fee revenues has long been a source of concern to aviation users.) Thus, under the conditions projected by the FAA, the trust fund appears headed for a period of financial stability.

Major Uncertainties. Signs of renewed economic growth and a recovery in passenger mileage--the underpinnings for FAA's projected yields--are already visible, and yields appear to have stabilized, at least for the time being. But yields are unlikely to increase over the short run to the level projected by the FAA. The nation's real gross national product grew by 0.5 percent in the January-March quarter of 1983, relative to the same quarter in 1982, while airline traffic increased by 10 percent over the rate recorded for the previous year. But as yields dropped by 3.5 percent in January and February, this increase appears due in part to continued price wars.